How to
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HOW TO
RELIEVE THE DEPRESSION

A SUGGESTION
FOR RAILROAD MEN AND BANKERS

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According to modern observations the degree of a country's prosperity and business activity bears a close relation to the extent of new constructions and improvements that happen to be under way. Of such there has been no lack in recent years; the steady increase of our country's wealth, of three or four billions per annum, having consisted chiefly of new constructions. The cash capital needed for these was supplied, to a small extent, by credit institutions—about $600,000,000 per annum; the bulk of it coming from the people's savings and surplus earnings.

After the panic set in, reducing earnings all around, the people's saving power became smaller and may not exceed two billions per annum at present. But the extent of new constructions has dwindled down much more and may, at present, not absorb more than half of the people's savings. What becomes of the balance? Naturally, these savings will, first of all, appear in the commercial banks, forming the idle cash funds of the money market. But only a small share of them will stay there; the bulk will flow out again, and will finally return into the channels of production and trade, without leading to any visible results. The modus operandi of this peculiar process has never been explained by our economists. It has been argued that the funds so absorbed at times of depression were needed for the money market's "other requirements," resulting from borrowing, straining of credit, etc., and that, on this account, an extended depression was really a matter of necessity, to readjust those strains. I have made this subject the study of my life and have found that those "other requirements" do not exist and that at times of depression the people's savings meet

their investment largely in a manner quite injurious to the country's welfare. The supposed inherent necessity for an extended depression cannot be substantiated, and the sooner we discard this supposition the better. And again, the sooner we can divert the investment of savings funds from that injurious course (the nature of which I shall explain in a subsequent publication) and direct them to their legitimate sphere, enterprise and new constructions—where they would give employment to some of the working forces now idle—the better for all concerned.

What prevents the idle funds of the money market from going into enterprise and new constructions, the same as before? They are prevented by the lack of demand.

Before the panic the demand for commodities seemed to be insatiable, and the means of production (factories, etc.) had to be constantly increased to enable production to keep pace with the ever-increasing demand. After the panic set in this demand dwindled down considerably, and the productive capital then in existence proved to be more than sufficient to provide for the reduced demand, so the incentive for new constructions and for the extension of productive capital had disappeared—and therewith the opportunity for investing cash funds and savings funds in their legitimate sphere. Instead of the dearth of cash capital so noticeable before the panic we now see a plentiful supply of funds in the money market, with apparently no use for them.

To find useful employment for these funds where there is no need for them in the lines of industry, that may seem a hopeless task. Yet there is one line which possibly may allow us to put our lever in, and that is—the railroad industry. This is situated quite differently from the other great industries. It has not, like these, doubled or trebled in extent during the past ten years, but has expanded only at a moderate percentage, so far as capital and mileage are concerned; while, on the other hand, traffic and earnings have increased enormously. In consequence, many of the railroads are sorely pressed for extending their facilities, even though this may not seem true just at present. They need cash capital, not only to pay debts recently incurred, but to provide for future requirements. According to the opinion of Mr. James J. Hill, these requirements will call for the stupendous sum of a billion dollars annually for a number of years to come.

Thus, we find a strange paradox in the money market—on the one hand a superfluity of cash funds looking for employment; on the other a number of railroads looking for cash funds which they cannot get. Why can't they? What stands in the way against bond issues at a reasonable rate of interest, say 4 or 4½ per cent?

I attribute the cause to three distinct reasons: First, distrust, arising partly from foolish State legislation, attempting to harass the railroads, partly from sharp practices on the part of railway magnates, such as led to the wrecking of the bonds of Rock Island and of Metropolitan Street Railway; second, the low market prices (which seem to justify that distrust) of the bonds and stocks already extant; why should investors subscribe to new bond issues at par if they can buy similar bonds below par in the open market? third, investors have the idea that after the return of prosperity, when the interest rate will rule higher, they can invest their funds to better advantage than now.

As to this last point, people are mistaken, so far as concerns the purchase of bonds and securities. Let us take an example, say, Union Pacific 4 per cent. bonds; at the boom time they were selling around 106, now at 100—so the investor can buy them to better advantage now than before. By rights those bonds, of almost absolute security as they are, ought to sell higher than at the time of the boom, now that the rate of interest rules low. Their reduced price is really paradoxical. It is due to the general feeling of uncertainty, which cannot last much longer, and as soon as it disappears, the security prices, as everybody knows, will go up.

As to point two, this embodies another paradox, namely, that most investors will buy securities when they are high rather than when they are low. At present they are altogether too low to look inviting to the average investor. It may seem a bold assertion that if our big financiers would simply mark up the prices of securities; not only mark them up, but keep them up (which is not a difficult matter for them to do), the securities would be bought much more eagerly than now; and not only securities already extant, but new issues as well. This assertion is amply corroborated by past experience.

As to point one, we have to admit that the general distrust and the feeling of uncertainty have much to do with the present unfortunate

situation. Owing to this feeling the railroads cannot borrow and the fact that they cannot borrow confirms that maleficent sentiment. Here it may be advisable to resort to manipulation in order to overcome that sentiment, at least so far as railroads are concerned. I suggest that a syndicate of prominent bankers be formed, guaranteeing the interest on new bond issues of railroads of good standing; the syndicate to have full power to guard the interests of the bondholders, say, by vetoing any measures of the managers which may endanger the safety of the bonds and eventually by foreclosure.

The syndicate may charge the railroads a fee of 5 per cent. of the amount of interest covered by the guarantee. This fee would constitute no burden for the railroads—just the reverse. Let us take an example. Last year the Union Pacific Railroad issued 4 per cent. convertible bonds at 90. Under the syndicate's guarantee these new bonds would be fully as safe and valuable as the railroad's first mortgage bonds, which at that time stood at 105. With the help of the syndicate's guarantee, therefore, the new bonds could have been issued at par and the railroad would have saved much more than the 5 per cent. fee.

The risk on the part of the syndicate would be only nominal, and the fee almost clear income. Such a syndicate arrangement would prove profitable all around—to its members, to the railroads, and (a hundred times more important than either) to the public in restoring confidence.

The syndicate may go even further in helping the railroads—by first getting their numerous "short term" notes out of the market. So long as these 5 and 6 per cent. notes can be bought below par, investors may not feel like buying new issues of 4 per cent. long term bonds at par. The syndicate may buy them up and procure the necessary funds in the same manner as the stock brokers do who hold securities for their customers on margin, borrowing the funds from the banks "on call" at less than 2 per cent. and charging their customers 4 per cent. For every million dollars of notes so bought, the syndicate would put a million dollars of idle cash funds into the hands of the sellers. The latter naturally will look for some other kind of investment for their funds, and may buy the long term bonds offered by the syndicate.

In conclusion, I will say, it would be folly under ordinary circumstances to try to relieve a depression by mere financial manipulation. With us, however, the situation is unusual—a great industry in need of funds and the money market weighted down with a plethora of funds—a situation which may not occur again in a lifetime. Here manipulation seems justified. Let us help the railroads, and they will help us. If we enable them to raise the funds they need for building and improving they will give employment and income to some of the working forces now idle; the latter, when expending their income in buying what they need, will call a further set of working forces into activity, and the well known interplay of action and reaction, thus started, may do its part toward relieving the depression, to some extent, at least.